No. 11796

United States

Circuit Court of Appeals

For the Ninth Circuit

CENTRAL INVESTMENT CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the Tax Court of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

The Tax Court of the United States

Docket No. 7959

CENTRAL INVESTMENT CORPORATION
(a corporation),

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPEARANCES

For Taxpayer:

THOMAS R. DEMPSEY, ESQ.,
ELMO H. CONLEY, ESQ.,
JOSEPH D. BRADY, ESQ.,

For Commissioner:

H. A. MELVILLE, ESQ.

DOCKET ENTRIES

1945

May 8—Petition received and filed. Taxpayer notified. Fee paid.

May 8—Copy of petition served on General Counsel.

June 20—Answer filed by General Counsel.

June 20—Request for hearing in Los Angeles, California, filed by General Counsel.

June 23—Notice issued placing proceeding on Los Angeles, California, calendar. Service of answer and request made.

1946

Sept. 11—Hearing set November 4, 1946, at Los Angeles, California.

Nov. 5—Hearing had before Judge Hill on merits. Briefs due 12/20/46. Replies 1/20/47.

Nov. 27—Transcript of hearing 11/5/46 filed.

Dec. 20—Brief filed by General Counsel.

Dec. 23—Brief filed by taxpayer. 12/24/46 Copy served.

1947

Jan. 20—Reply brief filed by taxpayer. 1/20/47 Copy served.

Jan. 22—Reply brief filed by General Counsel.

July 30—Findings of fact and opinion rendered. Judge Hill. Decision will be entered for respondent. Copy served.

July 31—Decision entered. Div. 15. Judge Black.

Aug. 19—Motion for review by the entire Court filed by taxpayer. 8/21/47 Denied.

1947

Oct. 30—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Oct. 30—Proof of service filed.

Oct. 30—Designation of contents of record on review filed by taxpayer with service acknowledged thereon.

Nov. 3—Certified copy of an order from 9th Circuit directing the Clerk of the Tax Court to transmit the original exhibits in lieu of copying same into the transcript prepared by the Clerk of the Tax Court, filed. [1*]

[Title of Tax Court and Cause.]

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:PB) dated March 21, 1945, and as a basis of its proceeding alleges as follows:

1. Petitioner is a corporation organized under the laws of California on October 6, 1921, with its principal office and place of business at Los Angeles, California. Its return for the taxable period here involved, the calendar year 1943, was filed with the Collector of Internal Revenue for the Sixth District of California.

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* Page numbering appearing at top of page of original certified Transcript.

2. The notice of deficiency (a copy of which, with accompanying statement, is attached hereto and marked [2] Exhibit A) was mailed to petitioner on March 21, 1945.

3. The taxes in controversy are excess-profits taxes for the calendar year 1943 in the full amount of the asserted deficiency, $34,971.23.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) Respondent erred in ruling and holding that petitioner is not entitled, under Section 23(c)(1) of the Internal Revenue Code, to a deduction for its taxable year ended December 31, 1943, in the amount of $43,174.36, the amount of a franchise tax which was imposed by the State of California and which accrued and became a lien on petitioner's real property on December 31, 1943.

(b) Respondent erred in failing to determine that there is no deficiency in petitioner's excess-profits tax liability for the calendar year 1943.

5. The facts upon which petitioner relies as a basis of this proceeding are as follows:

(a) At all times subsequent to the enactment, in the year 1929, of the "Bank and Corporation Franchise [3] Tax Act" of the State of California (Chapter 13, Laws of 1929, hereinafter referred to as the "Franchise Tax Act"), petitioner has been, and now is, a "corporation" within the meaning of Section 5 of said Act. At all times since the enactment of said Franchise Tax Act, petitioner has been, and now is, the owner of the real property

known as the Biltmore Hotel in the City of Los Angeles, and has been, and now is, "doing business within the limits of" the State of California within the meaning of Section 4(3) of said Act. At no time material hereto did the petitioner have pending any negotiations for the possible sale of its Biltmore Hotel property or contemplate dissolution or liquidation.

(b) At all times material hereto petitioner's annual accounting period has been the calendar year and petitioner has kept its books of account and made and filed its federal income and excess-profits tax returns on the accrual basis, which basis clearly reflects its income.

(c) During the calendar year 1944 petitioner duly filed with the Franchise Tax Commissioner of the State of California the franchise tax return required by [4] Section 13 of the aforesaid Franchise Tax Act, as amended. Said franchise tax return disclosed petitioner's gross and net income for the calendar year 1943, in the amounts of $1,957,-323.27 and $1,206,923.17, respectively, and disclosed a tax liability of $43,174.36. Said tax was imposed by Section 4(3) of the Franchise Tax Act and was determined, as provided in said section, "according to or measured by" the net income of petitioner for the calendar year 1943, to-wit, $1,206,923.17, and was correctly computed at the effective statutory percentage rate applicable to said net income. Said tax of $43,174.36 was set up on petitioner's books of account as a liability as of December 31, 1943, before the closing of said books for the calendar

year 1943, and was duly paid by petitioner to the Franchise Tax Commissioner in full during the calendar year 1944. Petitioner has never at any time disputed its liability for the whole or any part of said tax, has never filed any claim for refund or credit for the whole or any part thereof, and has never had, and does not now have, any intention of filing any such claim.

(d) In petitioner's federal income and excess-profits tax returns for the calendar year 1943 a deduction was claimed and taken for said franchise tax [5] in the amount of $43,174.36. In determining the deficiency here involved respondent disallowed said deduction in its entirety.

(e) Under the specific language of Section 4(7) of said Franchise Tax Act, as amended by Chapter 352 of the Laws of 1943, effective May 7, 1943, the aforesaid tax of $43,174.36 "accrued" on December 31, 1943.

(f) Under the specific language of Section 29 of said Franchise Tax Act, as amended by Chapters 37 and 352 of the Laws of 1943, effective May 7, 1943, the aforesaid tax of $43,174.36 constituted a lien upon the real property of the petitioner, with the same force, effect and priority of a judgment lien, and attached on December 31, 1943. The Biltmore Hotel property produced $1,946,468.64 out of petitioner's total gross income of $1,957,323.27 for the calendar year 1943, and likewise produced a large gross and net income during the calendar year 1944.

(g) Petitioner, at all times since the enactment of the Franchise Tax Act in 1929 to and including the close of its last completed taxable year on December 31, 1944, has consistently accrued the amount of California franchise tax on its books as of the date on which said [6] tax "accrued" and became a lien under the specific language of the Franchise Tax Act.

Wherefore, petitioner prays that The Tax Court of the United States hear this proceeding, determine that there is no deficiency in petitioner's excess-profits tax for the taxable and calendar year 1943, and grant such other and further relief as may be equitable in the premises.

/s/ THOMAS R. DEMPSEY,
/s/ ELMO H. CONLEY,
/s/ JOSEPH D. BRADY,
Counsel for Petitioner.

Dated, May 2, 1945. [7]

Verification

State of California,
County of Los Angeles—ss.

F. W. Flint, Jr., being first duly sworn, deposes and says: That he is President of Central Investment Corporation, taxpayer herein; that he has read the foregoing Petition and that the facts

therein stated are true and correct to the best of his knowledge, information and belief.

/s/ F. W. FLINT, JR.

Subscribed and sworn to before me this 2nd day of May, A.D. 1945.

PEARL M. KRUGER,

Notary Public in and for the County of Los Angeles, State of California.

My commission expires March 7, 1946. [8]

EXHIBIT A

[Letterhead Treasury Department, Internal Revenue Service]

Mar. 21, 1945.

Office of Internal Revenue Agent in Charge, Los Angeles Division. LA:IT:90D:PB

Central Investment Corporation
510 South Spring Street
Los Angeles 13, California

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1942, discloses an overassessment of $4,816.41, and that the determination of your declared value excess-profits tax liability for the taxable year mentioned discloses an overassessment of $850.86, and that the determination of your excess profits tax liability for the taxable year ended December 31, 1943, discloses a deficiency of $34,971.23, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,
JOSEPH D. NUNAN, JR.,
Commissioner,
By /s/ GEORGE D. MARTIN,
Internal Revenue Agent
in Charge.

PB:vmc
Enclosures:
Statement
Form of waiver
Form 843-4 [9]

STATEMENT

Tax Liability for the Taxable Years Ended December 31, 1942 and December 31, 1943

Year	Kind of Tax	Liability	Assessed	Over-assessment	Deficienc
1942	Income tax	$188,773.67	$193,590.08	$4,816.41	
1942	Declared value excess profits tax....	3,316.55	4,167.41	850.86	
1943	Excess profits tax ..	374,338.74	339,367.51		$34,971.2

In making this determination of your tax liability careful consideration has been given to the report of examination dated June 7, 1944, to your protest dated September 5, 1944, and to the statements made at the conferences held on September 28 and November 10, 1944.

The overassessments shown herein will be made the subject of certificates of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322(a) of the Internal Revenue Code, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent overassessments referred to in this letter, by filing with the collector of internal revenue for your district, claims for refund on form 843, copies of which are enclosed, the bases of which may be as set forth herein.

A copy of this letter and statement has been mailed to your representative, Mr. H. C. Diehl, Jr., 1003 Pacific Mutual Building, Los Angeles 14, California, in accordance with the authorization contained in the power of attorney executed by you. [10]

Taxable Year Ended December 31, 1942

ADJUSTMENT TO NET INCOME

Net income as disclosed by return	$488,142.61
Additional deduction: Capital stock tax	12,891.89
Net income adjusted	$475,250.72

Explanation of Adjustment

The correct amount of deduction for capital stock tax accrued is $18,750.00, whereas the amount claimed in your return is $5,858.11, an additional deduction of $12,891.89.

COMPUTATION OF DECLARED VALUE EXCESS-PROFITS TAX

Net income		$475,250.72
Less: 10% of $4,250,000.00, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1942		425,000.00
Net income subject to declared value excess-profits tax		$ 50,250.72
Declared value excess-profits tax:		
6.6% of $50,250.72	$3,316.55	
Correct declared value excess-profits tax liability		$ 3,316.55
Declared value excess-profits tax assessed:		
Original acct. No. 1437708		4,167.41
Overassessment of declared value excess-profits tax		$ 850.86

COMPUTATION OF INCOME TAX

Net income	$475,250.72
Less: Declared value excess-profits tax	3,316.55
Normal-tax net income	$471,934.17
Surtax net income	471,934.17
Income tax:	
Normal tax: 24% of $471,934.17	$113,264.20
Surtax: 16% of $471,934.17	75,509.47
Correct income tax liability	$188,773.67
Income tax assessed: Original, acct. No. 1437708	193,590.08
Overassessment of income tax	$ 4,816.41

Taxable Year Ended December 31, 1943

ADJUSTMENT TO EXCESS PROFITS NET INCOME

Excess profits net income as disclosed by return	$1,265,113.98
Unallowable deduction: California franchise tax	43,174.36
Excess profits net income adjusted	$1,308,288.34

EXPLANATION OF ADJUSTMENT

California State franchise tax paid during the year 1944, amounting to $43,174.36, treated as a deduction on your return for the calendar year 1943 is disallowed, since it is held that such taxes are properly allowable and deductible during the calendar year 1944 under section 23(c) of the Internal Revenue Code.

COMPUTATION OF ADJUSTED EXCESS PROFITS NET INCOME

Excess profits net income		$1,308,288.34
Less: Specific exemption	$ 5,000.00	
Excess profits credit (as claimed)	516,211.95	
Unused excess profits credit adjustment (as claimed)	324,929.80	846,141.75
Adjusted excess profits net income		$462,146.59

COMPUTATION OF EXCESS PROFITS TAX

Adjusted excess profits net income		$462,146.59
Excess profits tax: 90% of $462,146.59 [Limitation under section 710(a)(1)(B) not applicable]	$415,931.93	
Less: Credit for debt retirement	41,593.19	
Correct excess profits tax liability		$374,338.74
Excess profits tax assessed:		
Original, acct. No. 401072		339,367.51
Deficiency of excess profits tax		$ 34,971.23

Received and filed May 8, 1945. [13]

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1, 2, and 3. Admits the allegations contained in paragraphs 1, 2, and 3 of the petition.

4. Denies the allegations of error contained in subparagraphs (a) and (b) of paragraph 4 of the petition.

5(a) to (d), inclusive. Admits the allegations contained in subparagraphs (a) to (d), inclusive, of paragraph 5 of the petition.

5(e) to (g), inclusive. Denies the allegations contained in subparagraphs (e) to (g), inclusive, of paragraph 5 of the petition.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied. [14]

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL, ECC
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

E. C. CROUTER,

H. A. MELVILLE,
Special Attorneys,
Bureau of Internal Revenue.

HAM/ma 6/12/45.

Received and filed June 20, 1945. [15]

The Tax Court of the United States
Docket No. 7959

CENTRAL INVESTMENT CORP.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Los Angeles, California, November 5, 1946
2:00 P.M.

(Met pursuant to notice.)

Before: Honorable Samuel B. Hill,
Judge.

Appearances:

Joseph D. Brady, 631 Title Insurance Building, 433 South Spring Street; Thomas R. Dempsey, 1104 Pacific Mutual Building, 523 West Sixth Street, Los Angeles, California, appearing for the Petitioner.

H. A. Melville (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent. [18]

Proceedings

The Clerk: Docket No. 7959, Central Investment Corporation.

Mr. Brady: Ready for the Petitioner, your Honor.

The Court: Announce your appearances.

Mr. Brady: Mr. Reporter, will you kindly note the appearances for the Petitioner of Thomas R. Dempsey, who is here; of Joseph D. Brady, now speaking; of Elmo H. Conley and John O. Paulston, who are absent but who will contribute in the writing of the briefs.

Mr. Melville: H. A. Melville for the Respondent.

Opening Statement on Behalf of the Petitioner
By Mr. Brady

Mr. Brady: If your Honor please, this case involves an asserted deficiency in the taxpayer's excess profits taxes for the calendar year 1943 in the amount of $34,971.23. Now, this asserted deficiency is entirely attributable to the Commissioner's disallowance of a deduction of $43,174.36 which the taxpayer took in its return for the taxable year 1943, representing the amount of its California franchise tax based upon its net income for this same taxable year, the calendar year 1943.

Now, under applicable California statutes, your Honor, that franchise tax of $43,174.36 accrued and became a lien on December 31, 1943. The taxable year that we are talking about. The taxpayer set up a liability for that [19] amount on its books of account, which were kept on the accrual basis, on December 31, 1943. The taxpayer paid that state franchise tax of $43,174.36 in full during the year 1944 when it became due and payable. The taxpayer never questioned or disputed its liability for any part of that tax, has never filed any claim for

refund with respect thereto. As I say, in the return for this taxable year, the taxpayer deducted the amount of that franchise tax. The Commissioner disallowed the deduction, explaining his disallowance in the statement attached to the deficiency notice in the following language, which I should like to quote:

> "California State franchise tax paid during the year 1944, amounting to $43,174.36, treated as a deduction on your return for the calendar year 1943 is disallowed, since it is held that such taxes are properly allowable and deductible during the calendar year 1944 under section 23(c) of the Internal Revenue Code."

Now, the deficiency notice was mailed March 21, 1945. Presumably the disallowance was based upon I.T. 3646, promulgated early in 1944 by the Commissioner and now reported in 1944 Cumulative Bulletin, page 104. I have a copy of I.T. 3646 and shall be glad to file it with the Court if that would be a convenience to the Court.

The Court: It would be a convenience. We can get [20] it, but if you have an extra copy, you might just as well put it in the file here.

Mr. Brady: Now, as your Honor will observe from reading that I.T., the controversy between the parties here narrows down to the question whether the liability of $43,174.36 to the State of California accrued on December 31, 1943, our taxable year, as the Petitioner contends it is, or one day later, namely, January 1, 1944, as the Commissioner in that I.T. contends it did.

Now, the petitioner, Central Investment Corp., owns the Biltmore Hotel here in Los Angeles. Under the applicable California statute—which is the very Franchise Tax Act which imposed this tax of $43,174.36—a lien in favor of the State of California attached to the real estate of this taxpayer on December 31, 1943. The Petitioner contends that under correct construction of the Internal Revenue Code it was obligated to accrue that liability on December 31, 1943, the date on which the lien of the State of California attached to that real property.

Now, in the opinion of counsel for the Petitioner, your Honor, the facts admitted—pleaded in the petition and admitted in the Respondent's answer—are all of the facts necessary to enable this Court to determine the single question of law at issue in this case. The answer denies some of the allegations of the petition, some of the allegations [21] of fact in the petition, but counsel for the Petitioner do not believe those allegations so denied are material. The Petitioner, therefore, does not desire to offer any evidence but reserves the right, of course, to determine at the close of the Respondent's evidence whether or not the Petitioner will offer any evidence in rebuttal.

For the convenience of the Court I should like to hand your Honor a statement of the facts admitted by the pleadings. These facts are very brief. These facts are stated literally in the language of the petition.

Just one thing further, your Honor. I have here an extra copy of an official print by the California

State Printer in 1943 of the California Bank and Corporation Franchise Tax Act as amended in the year 1943. That is the statute which your Honor will have to apply in the determination of this question. Mr. Melville, I believe, has another copy of that same print, and it occurred to the Petitioner that it might be a convenience for the Court to have that in its file.

That is all, your Honor.

The Court: Does the Respondent care to make a statement?

Mr. Melville: Yes, your Honor. [22]

Opening Statement on Behalf of the Respondent
By Mr. Melville

Mr. Melville: The California Bank and Corporation Franchise Tax is imposed, assessed and collected from corporations for the privilege of doing business within the state for the taxable year to be computed upon the basis of the corporation's net income for the next preceding year. Now, because there was a slight amendment or two to that tax law as originally passed in 1929, which amendments occurred in 1943, the controversy in this case arose.

Under the prior law the tax accrued on the first day of the corporation's taxable year, the year for which it was paying for the privilege of doing business. Under the amendment the law, for reasons which we need not go into at this time, was changed so that it provides that the tax accrues on the last year—or the last day of the income year;

that is, December 31st of the year on which the income of which the tax is based, but the day prior to the beginning of the year during which the corporation is going to do business and for the privilege of which it is going to pay this franchise tax.

Now, the accrual date for Federal income tax purposes of this California Franchise Tax prior to the 1943 amendments was the subject of the following published rulings by the Bureau of Internal Revenue: [23]

I.T. 2770, C.B. 13-1, page 111, issued in 1934; I.T. 2971, C.B. 15-1, page 107, issued in 1936; I.T. 2988, C.B. 15-2, page 179, also issued in 1936.

Subsequent to the amendments in 1943, the question was again put up to the Bureau of Internal Revenue and again the accrual date for Federal income tax purposes of this California Franchise Tax was passed upon and a ruling published as I.T. 3646 appears in the Cumulative Bulletin 1944 at page 104.

This proceeding, your Honor, was brought to test the correctness of that ruling of the Bureau. I would like to point out that the importance of this case should not be judged from the amount of tax involved, the stable activities of the Petitioner which, as Mr. Brady has pointed out, is running the Biltmore Hotel, nor the willingness of the Petitioner's counsel to submit this case on the pleas. This, as I have indicated, is a test case and the importance of it is more readily indicated by the fact that three or four separate law firms appear on the petition. These law firms in turn, I under-

stand, have as their clients large manufacturing companies, principally in the aviation industry, which during 1943 had rather large incomes, and the importance to them I can indicate by pointing out that in our case by the simple disallowance of a deduction of $43,000-and-some-odd dollars, a deficiency in Federal tax of $34,000.00 arises. [24]

Because of these facts it is our belief that this test case will control the matter of perhaps millions of dollars of Federal revenue which will stand or fall on the basis of this one decision.

The Court: The Petitioner desires to offer no evidence at this time. Does the Respondent have any witnesses?

Mr. Melville: Mr. Freese, will you take the stand, please?

Whereupon,

HARRY R. FREESE

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Harry R. Freese, 410 North Edinburgh, Los Angeles.

Direct Examination

By Mr. Melville:

Q. Mr. Freese, what is your occupation?

A. I am district franchise tax auditor with the State of California, Franchise Tax Commissioner's office.

(Testimony of Harry R. Freese.)

Q. Does the Franchise Tax Commissioner's office have jurisdiction over the California Franchise Tax? A. Yes, sir. [25]

Q. Does it have jurisdiction over any other kind of taxes?

A. Yes, we are the administrative office for the Bank and Corporation Franchise Tax Act, the Corporation Income Tax Act, and the Personal Income Tax Act.

Q. You mentioned a corporation income tax. State, Mr. Freese, if you will, whether corporations in California are subject to both the income tax and the franchise tax.

A. No. Some corporations are subject to one act and some to the other. Corporations are not subject to both acts at the same time.

Q. What determines which act they are subject to?

A. Well, those corporations which, in accordance with the definitions which we have in our act that are doing business in the state, actively engaged in business, are subject to the Bank and Corporation Franchise Tax Act. Those corporations in general which are merely deriving income from the state but not actively engaged in business, such as for example, personal holding companies, are subject to the Corporation Income Tax Act.

Q. State whether or not, then, it is a true statement to say that the Franchise Tax is an excise tax imposed on corporations for the privilege of doing business in the State of California during the taxable year.

(Testimony of Harry R. Freese.)

Mr. Dempsey: I object, if your Honor please. It [26] calls for a legal conclusion of the witness.

The Court: I suppose it would appear from the act itself what the provisions are in that regard. This is calling for this witness' interpretation of what the act means.

Mr. Melville: I must admit that that is true, your Honor. I didn't think opposing counsel would dispute that point. They apparently intend to, though, and I will have to admit the act will speak for itself.

Do we want to confuse the Court by quibbling here as to whether a franchise tax is for the purpose of doing business or can we admit that?

Mr. Dempsey: We can admit that the tax here in question is a franchise tax levied under the Franchise Tax Act of California for the privilege of doing business. My reason for objecting to the question was that I didn't know what the witness' answer would be. I didn't care to be bound by it.

Mr. Melville: Quite all right. I appreciate your offer to stipulate and it is so stipulated.

With consent of opposing counsel, I offer in evidence a copy of the Bank and Corporation Franchise Tax Act, 1939; that is before the 1943 amendments.

The Court: Admitted.

Mr. Brady: Just a minute there. We have no objection to that being offered in evidence, but we would like to [27] have it understood that the 1943 print that I offered during my opening statement may be admitted in evidence also.

(Testimony of Harry R. Freese.)

Mr. Melville: May I introduce that in evidence, your Honor?

The Court: Yes, you may. I assumed that, at least so far as existing law is concerned, we would take judicial notice.

Mr. Melville: Yes, your Honor. This is for the Court's convenience.

The Court: It doesn't really have to be offered in evidence.

Mr. Melville: I want to show the comparison.

The Court: You can put them in evidence, both of them. Admitted as Respondent's Exhibit A for the one first offered, and what is the second offer?

(The document above-referred to was received in evidence and marked Respondent's Exhibit A.)

Mr. Melville: The 1943 Act, your Honor.

The Court: That is the one that Mr. Brady put in here?

Mr. Melville: Handed you, yes, your Honor.

The Court: Mark that Respondent's Exhibit B.

(The document above-referred to was received in evidence and marked Respondent's Exhibit B.)

The Court: I am just admitting it in evidence [28] simply because it will be convenient to have it here. I think we can take judicial notice of it.

Q. (By Mr. Melville): Mr. Freese, has the Corporation Commissioner issued any regulations under this 1943 Act?

A. You mean the Franchise Tax Commissioner?

(Testimony of Harry R. Freese.)

Q. Yes. A. No, not to my knowledge.

Q. Did he issue any regulations under the 1939 Act?

A. Well, now, when I say no regulations, I mean no codified regulations. There are office rulings and all published.

Q. But no published official regulations?

A. No.

Q. Did the Franchise Tax Commissioner at any time put out a printed leaflet of instructions to corporations to guide them in the preparation of their returns? A. Yes, sir.

Q. I hand you a leaflet and ask you if that is a copy of the instructions or guide to corporations?

A. Yes, sir, that is the leaflet put out to guide new corporations in the computation of their tax.

Q. And this is the closest thing that the Tax Commissioner has put out to a regulation?

A. Yes, sir. [29]

Mr. Melville: If your Honor please, I offer this in evidence.

Mr. Dempsey: We will waive objection to it, but supply us with a copy of it, if you please.

The Court: Admitted as Respondent's Exhibit C.

(The document above-referred to was received in evidence and marked Respondent's Exhibit C.)

Q. (By Mr. Melville): I note, Mr. Freese, that that Exhibit C has a printing date of 1942. Was that republished subsequent to the change in the 1943 Act? A. Not to my knowledge, no, sir.

(Testimony of Harry R. Freese.)

Q. Those instructions are still applicable, then, even under the 1943 amendments?

A. As near as I know, yes, sir.

Q. Mr. Freese, will you give us an illustration of how this corporation franchise tax worked under the prior law in comparison to under the new law? For example, take a foreign corporation which began business, began doing business in California on January 1, 1942 and continued doing business for the entire calendar year 1942. Assume further that the corporation during that year had a taxable net income of $10,000.00. What would that corporation have to do to comply with the requirements of the law and your office with respect to this corporation franchise tax? [30]

A. Well, when the corporation would qualify, the Secretary of State would require that they prepay the minimum franchise tax, which at that time was $25.00. That would constitute a prepayment of tax for the taxable year 1942. When they filed their return for the income year 1942—I presume that this is on a calendar year basis—they would file the return on March 15th, 1943. At that time you assumed an income of $10,000.00. Well, at the rate of 4 per cent, we would have two computations of tax. We would have a tax forwards and backwards. We would have one tax of 4 per cent of $10,000.00, or $400.00, for the succeeding taxable period. That is the 1943 taxable period.

In addition to that we would have an adjustment of tax for the first taxable period, another $400.00

(Testimony of Harry R. Freese.)

less the $25.00 prepayment, or $375.00, with a return, the amount that would be due would be $375.00 plus one half of the $400.00, or $200.00, that would be. In other words, the total of tax paid on March 15 would be $575.00. The other $200.00 would be payable on September 15th.

Q. And that $575.00 would cover the privilege of doing business for what years?

A. Well, of that, $375.00 would be an adjustment of tax for the first taxable period, 1942, and it would constitute half of the tax for the 1943 taxable period. The other half of the 1943 taxable tax would be paid on September 15th. [31]

Q. Now, then, assuming that that same corporation continues doing business in the State of California throughout 1943, when did you say it would pay the remaining $200.00?

A. Well, that has to do with the payment of the tax. That would be due six months after the return, or September 15th. The entire tax is assessed on the return.

Q. Very well. Now, assuming it continued doing business for the entire year 1943, and during that period, or during that year, had another net income of an even $10,000.00. How would that be handled in your office by the taxpayer and your office?

A. That return would be filed on March 15th, 1944, and if, in your example, you assumed that when they qualified in the State of California in 1942 they commenced to do business immediately,

(Testimony of Harry R. Freese.)

so that the first income period was a full 12 months, then there would be no further adjustment on the return for 1943 income period, and if they had a $10,000.00 income during that period, why, the tax would be—the effective rate of the tax for the 1943 income year, I believe, was slightly reduced to 3.4 per cent, effective rate, and the tax would be 3.4 per cent of $10,000.00, and that would be for the taxable period 1944.

Q. That is for the privilege of doing business in 1944? A. That is correct, yes. [32]

Q. Now, assuming that same corporation continued doing business in California up until June the 30th, 1944, and then ceased doing business in California, whether by withdrawal or by dissolution, what would the tax be?

A. In a situation of that type, if the dissolution or withdrawal was not pursuant to reorganization as defined by our act, why, we would make a refund of a portion of the tax that had been measured by the prior year's income. If it was June 30th, we would make—and it was a calendar year return—we would make a refund and abatement of one half of the tax.

Q. Supposing it went out of business at the end of three months, 1944?

A. Our act provides for a pro-rata by months refund and abatement, and they would be required to pay only one quarter of the tax measured by the prior year's income.

(Testimony of Harry R. Freese.)

Q. And what if it went out of business during the first 15 days of 1944?

A. If it went out of business the first 15 days, any time up to the 15 days, if it did not do business during that first 15 days; that is, it actually ceased doing business, they would be subject to no tax. If they carried on some business during that first 15 days, we would subject them to the minimum tax.

Q. Of how much? [33]

A. At the present time it is twenty-one twenty-five.

Q. Do you mean by that $21.25?

A. That is correct, 85 per cent of $25.00.

Q. Do I understand then from your testimony that unless and until a corporation actually does business in the State of California for 16 days or more of the taxable year, no liability for the State Franchise Tax for that year arises?

Mr. Dempsey: If your Honor please, I think that calls for the witness' conclusion. I object.

The Court: Yes. I would rather like to hear the answer to it, though. I will overrule the objection.

The Witness: That is a rather difficult question.

The Court: Well, is it an open and shut proposition, or does it involve doubt?

The Witness: If he means on dissolution, yes. If he means on a beginning corporation that should operate for 15 days, they would be subject to tax. On a dissolution such as he mentioned before, we would subject them only to the minimum $25.00 tax —or to $21.25.

(Testimony of Harry R. Freese.)

Mr. Dempsey: Pardon me. I don't understand the question either, apparently. Would it be all right if we start over?

Mr. Melville: I will be glad to start over again.

Q. (By Mr. Melville): Assuming this same corporation, that is, that came into the state, started doing their business on January 1, 1942; it did business all during 1942 and all during 1943. I am just trying to make sure that we understand your testimony. Do I understand correctly that this same corporation now, that unless and until it actually did business for at least 15 days—no, at least 16 days in 1944, it did not become liable for the Corporation Franchise Tax for 1944?

A. Well, I don't know whether it would become liable for the tax. I could not state that. At any rate, we would compute the tax from an administrative standpoint if, as I mentioned before, if in the first 15 days they did no business whatsoever, they were dormant preparatory to dissolving or withdrawing, we would assess no tax whatsoever. If the tax was assessed and they filed returns, we would abate the tax. If, on the other hand, they did engage in some activity, some business activity in the first 15 days, we would assess the minimum tax for that period and collect that.

Q. But that minimum tax is assessed only if the corporation did some business during those 15 days?

A. Yes, that is my understanding of our act.

(Testimony of Harry R. Freese.)

The Court: Just a moment. When do you make the computation? When do you make the assessment as to a current taxable year? [35]

The Witness: Ordinarily it is not until the return is filed. However, on a corporation that is being dissolved or withdrawing, they will be required to file a return before we grant them a tax clearance, and until they have a tax clearance the Secretary of State won't allow them to dissolve or to withdraw.

Mr. Melville: Was that all, your Honor?

The Court: I believe so. Let's see. You are not attempting to answer, as I understand, when the liability might attach?

The Witness: No.

The Court: All right.

Q. (By Mr. Melville): Along that same line, the corporation that does business for the first six months of 1944, let's say, and then withdraws from the state or is dissolved, do they file a return showing their income for those first six months?

A. As a matter of fact, in the situation which you gave, that would not be required because in that computation or the example that you gave there was no second or third year liability attaching, therefore the income for that last six months, we would not require a return on that inasmuch as that would not be used to measure any tax. The tax for that period, 1944, would have been measured by the income for the income year 1943. [36]

(Testimony of Harry R. Freese.)

Q. And the income for 1944, if it had any significance at all, would be with respect to the franchise tax for 1945?

A. That is correct, with the exception, as I noted, of the possibility of adjusting backwards where a full year had not been operated.

Q. Mr. Freese, the returns of corporations filed with your office, are they retained in your office?

A. No. The Sacramento office of the Franchise Tax Commissioner keeps all returns. The only returns sent to Los Angeles are those for field audit and investigation.

Q. Then would the returns of this particular tax payer, the Central Investment Corporation, for 1943, would they be in Sacramento at this time?

A. I don't know where those returns are. I have no specific knowledge.

Q. Are they in your office?

A. I don't know.

Q. Would you explain, please. the mechanics now—take a return from the time it is filed and explain how the assessment and collection of the tax is handled in your office?

A. Well, the returns are filed two months and 15 days after the close of the income year. Those returns can either be filed in Los Angeles, in Sacramento, or in San Francisco. The returns are immediately assessed, the assessed [37] tax is set up as a liability against the corporation, and under our act the corporation, general business corporation, is required to pay one half of the tax with

(Testimony of Harry R. Freese.)

its return and one half of the tax shown six months thereafter. As far as the collection of the tax is concerned if the tax is not completely paid up within, I believe it is 12 months after the close of an income year, a corporation is suspended by the Secretary of State upon the request of the Franchise Tax Commissioner.

Of course collections of tax, the tax is an automatic lien on the real property of the corporation and on the self-assessed tax, and when we have any other additional tax liabilities against a corporation we may go through the lien provisions of our act, in effect a lien of personal property as well as real property.

Q. Your answer to my question was with respect to franchise tax, is that correct? A. Yes, sir.

Q. I just want to make sure of that point that all of my questions and your answers have been with reference to the franchise tax rather than income tax. Is that correct?

A. That is correct, yes, sir.

Q. Now, after the return has been filed and there is an office audit, do you have provision in your organization for investigation and perhaps asserting deficiencies? [38] A. Yes, sir.

Q. Will you explain how that works?

A. Our returns—we have a statute of limitations of four years, and those returns after they are filed are subject to either office audit or to field audit. If we feel that there is a deficiency in tax or a refund, why, we go through the provisions or the

(Testimony of Harry R. Freese.)

actions required by our act. If there is a deficiency, we issue a notice called a notice of proposed assessment, a notice of additional tax, that amounts to. The taxpayers have a right to protest that assertion of a deficiency within 60 days. Then they are entitled to the right of oral hearing and they usually submit a brief on their argument. The oral hearings are held in Los Angeles and San Francisco and in Sacramento. After the Commissioner's determination, after the appeal, he issues a notice of action. If that is not satisfactory to the taxpayer, he may then appeal further to the Board of Equalization or he may pay the tax and go to court and sue on a claim for refund.

Mr. Melville: You may cross-examine.

Mr. Dempsey: No cross-examination.

Mr. Melville: Thank you very much, Mr. Freese.

(Witness excused.)

The Court: Any other witnesses?

Mr. Melville: Yes, your Honor. Is Miss Kruger [39] in Court? Will you take the stand please, Miss Kruger.

Whereupon,

PEARL M. KRUGER

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Pearl M. Kruger, 510 South Spring Street, Los Angeles.

(Testimony of Pearl M. Kruger.)

Direct Examination

By Mr. Melville:

Q. Miss Kruger, what is your occupation?

A. Well, I am secretary of the company, of the Central Investment Corporation.

Q. Are you also treasurer?

A. Yes, secretary-treasurer.

Q. How long have you been working for the Petitioner?

A. Since it was organized in 1922.

Q. And how long have you been secretary-treasurer?

A. Since about January 1945.

Q. Who was secretary-treasurer in 1941?

A. James R. Martin.

Q. 1942? A. James R. Martin.

Q. 1943? [40] A. James R. Martin.

Q. And 1944?

A. Up until about December 23rd, James R. Martin.

Q. Is he now deceased? A. He is.

Q. Do you recognize when you see it the signature of James R. Martin?

A. Yes, I would know it.

Q. Is that also true of F. H. Flint, Jr.?

A. F. W. Flint, Jr., yes, sir.

Q. Miss Kruger, in response to a subpoena of this Court, did you bring with you the corporation's franchise tax returns, Form 105, for the years 1941 to 1944 inclusive, the retained copies?

A. Yes.

(Testimony of Pearl M. Kruger.)

Q. Refer, if you will please, to that return for 1942. When was that filed?

A. It was filed on April 26th, according to our transmittal letter that is enclosed here.

Q. What year? A. 1943.

Q. And for what year did that pay the franchise tax for the privilege of doing business?

Mr. Dempsey: If your Honor please, I think that calls for a legal conclusion of the witness. It will speak [41] for itself.

The Court: Well, what year do you have involved in this particular——

The Witness: It is the Bank and Corporation Franchise Tax return for the year 1942.

Q. (By Mr. Melville): What was the income year there? Does that 1942 refer to the income year or the taxable year?

A. It doesn't say on here.

Q. Well, do you know?

A. I didn't make out the tax returns.

Q. I appreciate that, but as treasurer of your corporation and one who has worked with it ever since it was formed, do you know what the income year involved in that return is?

A. I presume it was 1941.

Mr. Dempsey: Pardon me. May I ask the purpose of this?

Mr. Melville: Your Honor, I want to show during the examination of this witness how this tax affects their Federal tax liability. I want to show by a few questions with respect to 1942, 1943 and

(Testimony of Pearl M. Kruger.)

1944, that in 1943 they get the benefit, if the Court sustains the Petitioner's position in this case, of a double deduction for Federal income tax based upon the payment of the State California Franchise Tax. [42] That is all I wish to establish by this witness.

The Court: I don't know. Ask your question again. The objection was made it calls for a conclusion of the witness. Do you know from the document you have there the correct answer to the question asked you? In other words, is there anything there to indicate the correct answer?

The Witness: No, I don't believe there is.

Q. (By Mr. Melville): What does the year 1942 refer to, Miss Kruger?

A. I would say it is the year on which the tax was computed.

Q. Did you have to file in connection with that a copy of certain items of your corporation Federal income tax return for the year 1942?

A. I would have to examine the return because I have not seen them for some time and I did not make them out.

Q. Maybe I can help you.

A. I presume that is what was done, then.

The Court: Is that answer clear in the record?

Mr. Melville: That answer isn't satisfactory. I think I will introduce in evidence a copy of that return and let it speak for itself and ask leave to substitute a photostatic copy.

The Court: Of the retained franchise tax report of the Petitioner here? [43]

(Testimony of Pearl M. Kruger.)

Mr. Melville: For 1942, yes, your Honor.

Mr. Dempsey: If your Honor please, I object as not being relevant to the question here presented. This is a 1942 return and we have a tax for 1943 in question at this time.

The Court: Overrule the objection. You may offer it. It is admitted as Respondent's Exhibit D.

(The document above-referred to was received in evidence and marked Respondent's Exhibit D.)

The Court: I understand you are going to furnish a photostatic copy?

Mr. Melville: I would like to substitute a photostatic copy.

Mr. Brady: Does that mean the taxpayer will get this back very promptly?

Mr. Melville: I can't be sure how promptly, but as promptly as possible, Mr. Brady. The photostating will be done in Washington, D. C.

Mr. Brady: That is, it will be a month or two?

Mr. Melville: Oh, yes.

Q. (By Mr. Melville): Have you a retained copy of the corporation's franchise tax return for 1943? A. Yes, it is here.

Q. You didn't prepare this? [44]

A. No, our auditors prepare all the tax returns.

Q. When was that filed?

A. On May 5th, 1944.

Q. How much tax was due?

A. $43,174.36.

(Testimony of Pearl M. Kruger.)

Q. Was that paid, and if so, when?

A. $22,000.00 of it was paid when the return was filed on May 5th, 1944.

Q. And when was the balance paid?

A. The balance was paid by a transmittal letter dated September 1, 1944.

Mr. Melville: I offer that retained copy of the 1943 franchise tax return in evidence, your Honor.

Mr. Dempsey: No objection.

The Court: Admitted as Respondent's Exhibit E.

(The document above-referred to was received in evidence and marked Respondent's Exhibit E.)

The Court: You desire to substitute a photostatic copy for this also?

Mr. Melville: Yes, if your Honor please.

The Court: You may have that privilege.

Q. (By Mr. Melville): And do you have the corporation's retained copy of the franchise tax return for 1944? A. Yes, I do. [45]

Q. When was that filed?

A. April 13th, 1945.

Q. How much tax was due?

A. $45,815.23.

Q. And when was that paid?

A. $23,000.00 of it was paid when the return was filed on April 13th, 1945. The balance was paid on September 5th, 1945, $22,815.23.

Mr. Melville: If your Honor please, I offer in evidence the corporation's retained copy of the franchise tax return for 1944.

Mr. Dempsey: No objection.

The Court: Admitted as Respondent's Exhibit F.

(The document above-referred to was received in evidence and marked Respondent's Exhibit F.)

Mr. Melville: With permission to substitute a photostatic copy, if I may, please.

The Court: You may have that privilege.

Q. (By Mr. Melville): Miss Kruger, I hand you a Federal corporation income and declared value excess profits tax return for 1942 and ask you if you can identify it from the signatures thereon?

A. Yes. Mr. Flint's signature and Mr. Martin's, and I acknowledged it as a notary public myself.

Q. Can you tell me by referring to the schedule with respect to taxes whether a deduction was claimed for the California Franchise Tax on this 1942 Federal return?

Mr. Dempsey: If your Honor please, I would like to ask the purpose of the question.

Mr. Melville: I want to show how this franchise tax was handled for Federal income tax purposes before, during and after 1943 to show that a double deduction could result from the Court's decision in this case.

Mr. Dempsey: Object to it as being incompetent, irrelevant and immaterial.

(Testimony of Pearl M. Kruger.)

The Court: Overruled.

Q. (By Mr. Melville): Do you have the question in mind, Miss Kruger?

A. There is a deduction for the California Franchise Tax, yes, of $5,272.34.

Q. Does that correspond with any check that you have in your possession?

A. Yes, we have a check dated March 5th, 1942, for $5,272.34.

Q. Made payable to whom?

A. To the Franchise Tax Commissioner.

Q. And the date on that?

A. March 5th, 1942.

Mr. Melville: Thank you. [47]

The Court Have you offered that in evidence?

Mr. Melville: No, I have not. I have the information in the record that I wanted to get in.

The Court: Oh, I thought that was what you were objecting to, was the offer in evidence.

Mr. Dempsey: My objection was to the question.

Q. (By Mr. Melville): Miss Kruger, I hand you another document and ask you if from the signatures on that document you can identify it?

A. Yes, that is Mr. Flint's signature and Mr. Martin's signature with my signature as a notary public.

Q. And what is the document?

A. It is the United States corporation income and declared value excess profits tax return for the calendar year 1943.

(Testimony of Pearl M. Kruger.)

Q. And I direct your attention to the schedule setting forth the taxes and ask you to read into the record the second and third items, including the amounts.

A. "California Franchise Tax for the year 1943, $19,736.60; California Franchise Tax for the year 1944, $43,174.36."

Q. Do you have in your possession any checks which correspond with those figures?

A. Not those specific figures, no. [48]

Q. Was the amount of $19,736.60 paid?

A. It was paid, yes.

Q. Do you have the checks to substantiate the payment?

A. There are a couple of checks here, one dated April 26th, 1943, and one dated September 7th, 1943, the total of which would probably amount to $19,736.60.

Q. Would you mind adding them up and be more positive about your testimony?

A. I would have to have a pencil.

Q. I will be glad to furnish you one.

A. I get $19,804.04, but one of them includes an item of interest of $67.44. I suppose when that is deducted, $67.44, it will be the amount of the tax, $19,736.60—yes.

Q. And the dates of those checks and the amounts again?

A. April 16, 1943, $9,935.74. That is tax. $9,868.30 plus interest, $67.44. The second check is dated September 7th, 1943, for $9,868.30.

(Testimony of Pearl M. Kruger.)

Q. Thank you. Now will you identify the checks, please, together with the dates and amounts which substantiate your payment of $43,174.36?

A. Well, there is a check dated March 13th, 1944, for $22,000.00, one dated September 1, 1944, for $7,000.00, another dated September 1, 1944, for $9,000.00, and another [49] one dated September 1, 1944, for $5,174.36. The total of those checks is $43,174.36.

Mr. Melville: No more questions.

The Witness: Do I take these with me?

The Court: The lady was asking about these documents.

Mr. Melville: I have introduced in evidence, your Honor, everything from her documents that I want in.

The Witness: Then I take them with me?

Mr. Melville: Yes.

The Court: Have you any questions of this witness?

Mr. Dempsey: No questions.

The Court: Any further witnesses?

Mr. Melville: One moment, please, your Honor. I have no more witnesses but I want to consider one more point.

Mr. Brady: If your Honor please, may I ask Miss Kruger just one question?

The Court: Yes.

(Testimony of Pearl M. Kruger.)

Cross-Examination

By Mr. Brady:

Q. Miss Kruger, do you know how many stockholders the Central Investment Corporation had on December 31, 1943?

A. Well, I would say it was around 650 or something like that. [50]

Q. How many outstanding shares did it have on that date? A. 58,563 shares.

Mr. Brady: That's all.

(Witness excused.)

Mr. Melville: Your Honor, I am offering in evidence the Federal corporation excess profits tax return for the taxable year involved in this proceeding; that is, for the calendar year 1943, and ask leave to substitute a photostatic copy.

Mr. Dempsey: No objection.

The Court: Admitted as Respondent's Exhibit G.

(The document above-referred to was received in evidence and marked Respondent's Exhibit G.)

Mr. Melville: The Government rests.

Mr. Dempsey: The Petitioner rests.

Mr. Brady: The Petitioner rests, your Honor.

The Court: Both parties rest. You may have 45 days for simultaneous briefs and 15 days for answering briefs.

Mr. Melville: Thank you, your Honor.

Mr. Brady: If your Honor please, we have our brief written. We can file it in 15 days, if you would like to have us open, with Respondent replying to that, and our replying. [51]

Mr. Melville: I am satisfied with the rule of the Court that we file simultaneous briefs within 45 days. If Mr. Brady gets his in in 15 days, why, then he is not rushed.

The Court: It gives you a chance to answer his brief. There might be some advantage to you in that.

Mr. Melville: May I have 45 days to answer, your Honor? I am thinking about other cases I have.

Mr. Brady: I will file the brief in Washington 15 days from today's date, your Honor.

The Court: I am not trying to force you into something. If you want simultaneous briefs, it is all right with me.

Mr. Melville: I am perfectly willing to file either simultaneous briefs in 45 days or reply to his brief in 45 days after I receive service.

The Court: Make them simultaneous briefs in 45 days and the answers in 15 days.

Mr. Brady: How much for the reply briefs?

The Court: 15.

Mr. Brady: We can't handle it with six days each way in transportation.

The Court: How about 30 days?

Mr. Brady: 30 days would be better.

The Court: 45 days for simultaneous briefs and 30 days for reply briefs. [52]

Mr. Melville: Thank you.

(Thereupon, at 3:00 o'clock p.m., Tuesday, November 5, 1946, the hearing in the above-entitled matter was closed.)

Filed Nov. 27, 1946. [53]

The Tax Court of the United States
9 T. C. No. 17

Docket No. 7959

CENTRAL INVESTMENT CORPORATION
(a corporation),

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated July 30, 1947

California franchise tax imposed for the privilege of doing business during 1944, which tax is measured by income realized in 1943, held, to accrue and be deductible for Federal tax purposes in 1944.

Joseph D. Brady, Esq., and Thomas R. Dempsey, Esq., for the petitioner.

H. A. Melville, Esq., for the respondent.

FINDINGS OF FACT AND OPINION

Respondent determined a deficiency in petitioner's excess profits tax liability for the calendar year 1943 in the amount of $34,971.23. The deficiency results from the disallowance of a deduction in the amount of $43,174.36 on account of California franchise tax. The question is whether the California franchise tax is deductible in 1943, as petitioner contends, or in 1944, as respondent contends. Petitioner's excess profits tax return [54] for the calendar year 1943 was filed with the collector of internal revenue for the sixth district of California on the accrual basis, which basis clearly reflects its income. The case was submitted on oral testimony and exhibits.

Findings of Fact

Petitioner is a California corporation organized October 6, 1921, with its principal offices located in Los Angeles, where it owns the Biltmore Hotel. At no time material hereto did petitioner have any pending negotiations for the possible sale of its Biltmore Hotel property or contemplate dissolution or liquidation.

In 1929 the California Legislature enacted the Bank and Corporation Franchise Tax Act, Chapter 13, Laws of 1929, hereinafter referred to as the Act. Petitioner is and has been subject to the Act as a corporation as defined in such Act. The Act, as amended in 1943 in section 4(3), provides that corporations doing business in California and not

otherwise exempt "shall annually pay to the State, for the privilege of exercising its corporate franchises * * *, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of 4 per centum upon the basis of its net income for the next preceding fiscal or calendar year. In any event, each such corporation shall pay annually to the State, for the said privilege, a minimum tax of twenty-five dollars ($25)."

Section 11 provides in part that:

> Sec. 11. Definitions. (a) The term "income year," as herein used, means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed herein. "Income year" includes, in the case of a return made for a fractional part of a year, the period for which such return is made.
>
> (b) The term "taxable year," as herein used, means the calendar year, or the fiscal year ending during such calendar year, for which the tax is payable. A "taxable year" may constitute a period of 12 months or of less duration.

Section 4(7) provides that:

> (7) Accrual date. Taxes under this section and under Sections 1 and 2 of this act shall accrue on the last day of the "income year," as defined in Section 11 hereof.

Section 29(a) provides in part that:

> The taxes imposed by this act and disclosed on the return shall constitute a lien upon the real property of the taxpayer, which lien shall have the same force, effect and priority as a judgment lien and shall attach on the last day of the "income year," * * *

Prior to the 1943 amendment of the Act, the Act provided that the tax accrued and the lien therefor attached on the first day of the taxable year.

Section 13 of the Act requires every corporation subject to the tax to file a return within two months and fifteen days after the close of its income year.

Section 23 provides in part that:

* * * * * * *

> Corporations. In the case of corporations of the classes referred to in subdivision (3) of section 4 of this act, one-half the amount of tax disclosed by the return shall be due and payable as a first installment of the tax on such corporations on or before the fifteenth day of the third month following the close of the income year, as defined in section 11 hereof. The balance of the tax shall be due and payable as a second installment on or before the fifteenth day of the ninth month following the close of the income year. A tax imposed by this act or any installment thereof may be paid at the election of the taxpayer, prior to the date prescribed for its payment. [56]

Various subparagraphs of section 13 of the Act deal with the computation of the franchise tax in situations wherein corporations are commencing business in their first taxable year or are withdrawn or dissolved within the taxable year. In the case of commencing corporations it is provided in general that the tax for the first taxable year shall be based on the income of such year and paid during the second year. With respect to corporations withdrawing or dissolving during the taxable year it is provided in general that the tax for such taxable year be reduced on account of the portion of such year during which the taxpayer does not do business in California.

For the privilege of doing business within the state during the calendar year 1943 the petitioner duly filed on April 26, 1943, with the Franchise Tax Commissioner of the State of California the franchise tax return required by Section 13 of the Franchise Tax Act. This franchise tax return disclosed petitioner's gross and net incomes for the calendar year 1942 and a franchise tax liability of $19,736.60, which was paid by two checks—one dated April 16, 1943, for $9,868.30 and the other dated September 7, 1943, for $9,868.30.

For the privilege of doing business within the state during the calendar year 1944 the petitioner on May 5, 1944, duly filed with the Franchise Tax Commissioner of the State of California the franchise tax return required by Section 13 of the aforesaid Franchise Tax Act, as amended. This franchise tax return disclosed petitioner's gross and net

income for the calendar year 1943, in the amounts of $1,957,323.27 and $1,206,923.17, respectively, and disclosed a franchise tax liability of $43,174.36. The tax was imposed by Section 4(3) of the Franchise Tax Act and was determined, as provided in that section, "according to or measured by" the net income of petitioner for the calendar year 1943, to-wit, $1,206,923.17, and was correctly computed at the effective statutory percentage rate applicable to the net income. The tax of $43,174.36 was set up on petitioner's books of account as a liability as of December 31, 1943, before the closing of such books for the calendar year 1943, and was duly paid by petitioner to the Franchise Tax Commissioner as follows: $22,000 by check dated March 13, 1944, and $21,174.36 by three checks all dated September 1, 1944. The petitioner has never at any time disputed its liability for the whole or any part of such tax, has never filed any claim for refund or credit for the whole or any part thereof, and has never had, and does not now have, any intention of filing any such claim.

In filing its Federal income and excess-profits tax returns for the calendar year 1943 the petitioner claimed deductions not only for the California franchise tax imposed for the privilege of doing business in the state during 1943 in the amount of $19,736.60 but also for the California franchise tax imposed for the privilege of doing business in the state during 1944 in the amount of $43,174.36.

Respondent, in his statement accompanying the deficiency notice with respect to 1943 stated: [58]

California State franchise tax paid during the year 1944, amounting to $43,174.36, treated as a deduction on your return for the calendar year 1943 is disallowed, since it is held that such taxes are properly allowable and deductible during the calendar year 1944 under section 23(c) of the Internal Revenue Code.

Opinion

Hill, Judge: The problem for our determination is whether the California franchise tax imposed for the privilege of doing business during 1944 is deductible for Federal tax purposes in 1944, as respondent contends, or is deductible in 1943, the year giving rise to the income which furnishes the measure for the tax, as petitioner contends.

California imposes a tax on corporations for the privilege of doing business in the state during a given year, which year of privilege is designated the "taxable year." The tax so imposed is, with certain exceptions not here material, a percentage of the income of the preceding year, which preceding year is designated the "income year." Prior to 1943 the tax by the terms of the Act accrued and a lien therefor attached on the first day of the "taxable year." By amendment in 1943 it was provided that the tax accrued and a lien therefor attached on the last day of the "income year." It is this amendment which gives rise to the present problem.

Petitioner, being on an accrual and calendar year basis, contends that the franchise tax imposed for the privilege of doing business in 1944, the "taxable year," by its own terms accrued December 31, 1943,

and a valid lien under local law attached at that time. Petitioner argues from this that such tax was properly accrued and deducted by it in 1943 for Federal tax purposes. [59]

Petitioner's argument relies heavily on the fact that a valid lien under local law attaches on the last day of the "income year." Petitioner then cites the following cases which petitioner interprets as standing for the proposition that the proper date to accrue liability for taxes, for purposes of deduction under section 23(c), Internal Revenue Code, is the date when the lien to secure the payment of such taxes attaches, even though the taxes have not yet been assessed and are not yet due and payable. Magruder v. Supplee, 316 U. S. 394; California Sanitary Co. Ltd., 32 B. T. A. 122; and Crown-Zellerbach Corp., 43 B. T. A. 541. These cases are not considered applicable to the instant situation. These cases involved generally the question of who was liable for local property taxes as between transferor and transferee. In Magruder v. Supplee, supra, for instance, the taxpayer-vendee purchased real property on May 10, 1936. In January, 1936, the local taxes became due and payable on the property for the taxable year 1936 and a lien attached therefor at that time. The vendor was the one against whom the taxes were assessed and he became personally liable therefor prior to the sale. It was held that the vendee-taxpayer could not deduct in 1936 any local taxes paid by him on account of the property since he was not liable therefor. In California Sanitary Co. Ltd., supra, was involved

the California property tax which provided that property must be assessed for local tax purposes "to the persons by whom it was owned or claimed, or in whose possession or control it was, at twelve o'clock meridian of the first Monday in March * * *." A lien attached for the taxes at that time. We held that the taxpayer who acquired property subsequent to the lien date was not entitled to deduct taxes paid by him for that year on the [60] property because the transferor owning the property on the crucial date had become liable therefor. Crown-Zellerbach, supra, is essentially similar in principle to the California Sanitary case. None of these cases, in our opinion, is controlling of the question at hand because these cases involve property taxes, the personal liability for which arises by virtue of ownership at a specified time. A transfer of the property subsequent to the existence of a personal liability for the taxes thereon has no effect on such liability. In these cases the personal liability for the taxes as of the specified day of ownership and the lien attaching therefor arise simultaneously and no subsequent events can control or alter the liability therefor, despite the fact such taxes may be considered as covering a taxable period subsequent to the existence of the liability. In this connection the Supreme Court in Magruder v. Supplee, supra, said that real estate taxes "are not like rent, nor are they paid for the privilege of occupying property for any given period of time." The nature and character of the franchise tax here in question is essentially differ-

ent from the property taxes involved in the above discussed cases. The franchise tax is imposed for the privilege of doing business during the "taxable year." It is true that such tax is measured by the preceding year's income but it is not an income tax on such income but rather an excise tax for the privilege of doing business in the "taxable year" subsequent to the "income year." That the tax is essentially a tax on the privilege of doing business in the "taxable year" is clear from the terms of the Act and further from the fact that withdrawal or [61] dissolution relieves the taxpayer from taxation for the period of the "taxable year" during which the franchise privilege is not exercised. Therefore, on the last day of the "income year" we are unable to see how any liability can arise for a tax imposed on the privilege of doing business for a year not yet commenced. It is true that on the last day of the "income year" the facts are available which may constitute one of the basic elements of the prospective tax computation and it may also be that then it may seem almost inevitable that some liability will arise by virtue of the next day being the first day of the "taxable year." But however inevitable its prospective existence may seem on the last day of the "income year," the tax being for the privilege of doing business in the taxable year, the liability therefor arises only with and from the exercise of such privilege. If no business operations were carried on in the taxable year the tax would not be imposed.

In the instant case the franchise tax for the

privilege of doing business in 1943 was properly taken and allowed as a deduction in petitioner's tax return for 1943, the year before us. The tax here in question was imposed on the privilege of doing business in 1944 and not in 1943. We think it is not open to argument that the obligation to pay this tax was an expense of petitioner's business operations in 1944. It was, therefore, an expense which must necessarily be taken into account in the tax year 1944 in order properly to reflect petitioner's net income in that year. A business expense incurred which is attributable to the business operations of a particular tax year or period is, for the purpose of the Federal income tax, accruable in such year. U. S. v. Anderson, et al., 269 U. S. 422; Petaluma & Santa Rosa R.R. Co., 11 B. T. A. 541; H. H. Brown Co., 8 B. T. A. 112; Durst Productions Corporation, 8 T. C. ..... No. 158 (promulgated June 27, 1947). [62]

In the Anderson case, referring to the right to keep books and make income tax returns on the accrual basis, the Supreme Court said:

> * * * It was to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; and indeed, to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis.

(2) The appellee's true income for the year 1916 could not have been determined without deducting from its gross income for the year the total cost and expenses attributable to the production of that income during the year.

The Petaluma & Santa Rosa R. R. Co. case involved accrual date of the California franchise tax on public utilities measured by a certain percentage of the gross receipts on account of business done during the last preceding tax year. Sections of the California Code applicable were 3664a, 3665a, 3668, 3668b and 3668c as they existed in the years there involved. Petitioner contended that the franchise taxes which were assessed and became due and payable in 1921 were deductible in 1920 upon the theory that they were based upon the earnings of the prior year. The tax year there involved was 1921. We held that "a consideration of the statute leads us to to conclusion that there was no liability for the 1921 tax created by any events which occurred in 1920. If the corporation did not own the franchise and other property in 1921 there was not liability for the tax for that year, although the measure existed by which it could have been determined, if there was any liability. The 1921 tax was an expense of the business for that year and not for the prior year and it can not be deducted in the prior year as an accrued liability." The California statute [63] provided that the franchise tax there in question became a lien on the property involved on the first Monday of March of the tax year.

In the H. H. Brown case we said:

> The basic idea under the accrual system of accounting is that the books shall immediately reflect obligations and expenses definitely incurred and income definitely earned without regard to whether payment has been made or whether payment is due. Expenses incurred in the operations for a particular year are properly accrued in the accounts for that year, although payment may not be due until the following year.

Article 9A of New York Consolidated Laws, involved in the case of Durst Productions Corporation, imposes a corporation franchise tax each year for the privilege of doing business in that State. The tax is measured by a stated percentage of the "entire net income" of the year for which the tax is imposed but it is payable and a lien therefor attaches in a subsequent taxable year. In the Durst case we said: "The tax being calculated on the amount of earnings for the year in issue its charge against those earnings seems to accord with the theory of accrual."

Nor do we think that the wording of the Act to the effect that the tax accrues and the lien therefor attaches on the last day of the "income year" alters the situation. These provisions of the Act, in our opinion, only have significance in terms of priority of liens, and do not affect the question of accrual for Federal tax purposes. Since the provisions of the Act, specifying the last day of the "income year"

as the time of accrual and as the lien date, are for a special and limited purpose only i.e., priority of liens, and has reality in this connection only as it relates back from a delinquency occurring in the "taxable year," we do not think such provisions can be considered determinative of the question before us. [64]

Respondent has ruled that the California franchise tax before us in deductible for Federal tax purposes in the "taxable year." I.T. 3446 C. B. 1944, p. 104. This ruling to us seems proper and is consistent with the treatment accorded other state franchise taxes.[1] For the reasons above indicated we hold that the California franchise tax for 1944 accrued for Federal tax purposes in 1944 and was deductible in that year rather than 1943.

Decision will be entered for respondent.

[Seal]

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[1]Illinois, I.T. 3186, C.B. 1938-1, p. 140; Kentucky I.T. 3232, C.B. 1938-2, p. 70; Maryland, I.T. 3192; C.B. 1938-1, p. 144; Massachusetts, G. C. M. 22525 C.B. 1941-1, p. 350; Michigan, I.T. 3047, C.B. 1937-1, p. 66; Oklahoma, I.T. 3136, C.B. 1937-2, p. 100; Pennsylvania, I.T. 3189, C.B. 1938-1, p. 141; Tennessee, I.T. 3150 and 3151, C.B. 1938-1, pp. 125, 126. The Connecticut tax has been ruled to accrue on the last day of the "income year," I.T. 2935, C.B. XIV-2, p. 91, but it is difficult to determine from reading the state statute (chapter 66 b, Cumulative Supplement to Connecticut General Statutes, January sessions, 1931, 1933, 1935) whether the tax is imposed for the privilege of doing business during the "income year" or the "taxable year." See in this connection "Deductions for Accrued Taxes." 14 Taxes 197.

The Tax Court of the United States
Docket No. 7959

CENTRAL INVESTMENT CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion promulgated July 30, 1947, it is Ordered and Decided: That there is a deficiency in excess profits tax for the calendar year 1943 in the amount of $34,971.23.

[Seal] /s/ EUGENE BLACK,
Judge.

Entered: July 31, 1947.

[Title of Tax Court and Cause.]

MOTION FOR REVIEW BY THE COURT OF REPORT OF A DIVISION (JUDGE HILL)

To the Presiding Judge of the Tax Court of the United States:

Petitioner respectfully prays that the Presiding Judge exercise the discretion conferred on him by Section 1118(b), I.R.C., and direct that the de-

cision promulgated in the above proceeding on July 30, 1947, be set aside and that the matter be reviewed by the entire Court.

The sole issue is as to whether the California franchise tax imposed for the privilege of doing business during 1944, but measured by income realized in 1943, accrued and became deductible for federal tax purposes in 1943 or in 1944.

This petition for review is based upon the [67] grounds——

> (1) that the question involved is one of importance to all corporate taxpayers who have paid California franchise taxes for any taxable year ending after May 7, 1943, and
>
> (2) that the decision promulgated herein on July 30, 1947, contains important errors which should not be permitted to remain uncorrected by this Court.

(1) Importance of Question.

This case is one of first impression, so far as the particular tax is concerned. As the opinion of Judge Hill points out, the California statute imposes a tax on corporations for the privilege of doing business in the state during a given year designated as the "taxable year," the tax being measured, however, by the income of the preceding year, which is designated the "income year." Prior to May 7, 1943, the tax, by the terms of the California Bank and Franchise Tax Act (hereinafter referred to as the Act), accrued and became a lien on the first day of the "taxable year," but, by an

amendment which became effective on that date, it was provided that the tax accrued and became a lien on the last day of the "income year." Thus, with respect to all taxable years ending on or after May 7, 1943, the problem presented in the present case arises as [68] to all corporations doing business in California and keeping their books and making their returns on the accrual basis. The Commissioner has ruled (I. T. 3446, C. B. 1944, page 104) that, notwithstanding the 1943 amendment, the California franchise tax is deductible for federal tax purposes in the "taxable year" of the corporation. The present case, however, is the first proceeding before any court involving the effect of the 1943 amendment and the propriety of said ruling by the Commissioner. The importance in terms of the number of corporations involved and the amount of taxes involved is indicated by the Bank and Corporation Franchise Tax Statistics of 1943 Returns published by the California Franchise Tax Commissioner on March 1, 1945, wherein it is stated that 13,904 corporations filed California franchise tax returns for the "income year" 1943 and paid taxes aggregating in excess of $63,000,000. Unquestionably, at least as many corporations paid at least as much tax in each of the succeeding years.

(2) Important Errors in Opinion.

The decision promulgated on July 30, 1947, should be reviewed by the entire Court, also, in order to correct certain patent errors therein.

(a) Effect of Local Law Accrual Provisions.

The basic error involved in the decision is the

conclusion or assumption by the Trial Judge that the case is one which calls for a determination as to the proper date of accrual of the franchise tax according to the nature of that tax and without regard to the express provisions of the Act specifying a date as of which liability therefor shall accrue and as of which a lien in support of such liability shall attach to the property of the taxpayer. Thus, the only mention in the opinion of the statutory provisions in regard to the accrual and lien date (other than the reference, at page 6, to the fact that the petitioner relies upon such provisions) is the following statement at page 11 of the opinion:*

> "Nor do we think that the wording of the Act to the effect that the tax accrues and the lien therefor attaches on the last day of the 'income year' alters the situation. These provisions of the Act, in our opinion, only have significance in terms of priority of liens, and do not affect the question of accrual for Federal tax purposes. Since the provisions of the Act, specifying the last day of the 'income year' as the time of accrual and as the lien date, are for a special and limited purpose only, i.e., priority of liens, and has reality in this connection only as it relates back from a delinquency occurring in the 'taxable year', we do not think such provisions can be considered determinative of the question before us."

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*This reference is to the mimeographed copy of the opinion sent to counsel by the Clerk.

Reading the balance of the opinion with this last-quoted statement in mind, it is evidence that the Trial Judge was merely determining when the franchise tax would have accrued if there had been no provision at all in the statute with respect to an accrual date or a lien in support of the tax. Thus, at pages 8 and 9 of the Opinion, the Court considers the nature and character of the franchise tax and concludes, on the basis of such study, that "Therefore, on the last day of the 'income year' we are unable to see how any liability can arise for a tax imposed on the privilege of doing business for a year not yet commenced." In other words, the Court assumes that the problem presented for decision is what would be the proper date of accrual of the tax, if there were no statutory accrual and lien date. However, regardless of what the Court might discern from its analysis of the nature of the tax, the fact remains that the Legislature of the State of California has expressly provided that the tax shall accrue and become a lien on the last day of the income year. That is how the liability arose which the petitioner herein accrued; it accrued because of the express statutory provisions creating such liability, not because of the nature of the tax. The nature of the tax has nothing to do with the proper accrual date under such circumstances.

It is to be observed that the Trial Judge in [71] effect concedes that the provisions of the Act did at least "have significance in terms of priority of liens." In fact, as shown by the decisions cited and discussed at pages 36 and following of Peti-

tioner's Opening Brief, the provision establishing the lien as of the last day of the income year gives the state a priority as against not only unsecured tax claims of the United States but also as against secured tax claims of the United States, the lien for which attached subsequent to the statutory lien date for the state tax. Thus, in the present case, if the Federal Government had filed a lien on January 1, 1944, the state's lien would have been superior thereto. Necessarily, in order to have this effect, there must have been a liability to be supported by the lien. If there was such liability supported by such a lien, it is difficult to perceive how it can be said that this is without significance for Federal tax purposes. The bare statutory accrual date should suffice to require the accrual on a taxpayer's books in accordance therewith, but here we have, in addition, such a lien in support of the tax as to show beyond reasonable doubt that, in specifying that the liability accrued as of the chosen date, the statute was not creating a meaningless picture.

In regard to the Court's conclusion that the provisions of the Act specifying the last day of the income [72] year as the date of accrual and as the lien date are for a special and limited purpose only, that is, "priority," we merely observe, for the present, that if this were true it is not apparent what object would have been accomplished by changing the accrual and lien date from the first day of the taxable year to the last day of the income year. Manifestly, the Leigislature had in mind the effect of such change upon the taxpayers, and was not

merely moving its own priority ahead one day. However, whatever may have been the "purpose" of the Legislature, the fact remains that the statute is in general terms—it does not create liability solely for such purpose, but prescribes without any limitations that the tax shall accrue on the last day of the income year (Sec. 4(7)) and that such liability shall be supported by the lien prescribed in Sec. 29 of the Act. The decision herein will be patently unsupportable if it is allowed to remain, as it is, based upon such a clear misinterpretation of the admittedly controlling local law.

(b) Applicability of principles established in property tax accrual cases.

The opinion also involves errors in its rejection of the principle, established by certain cases relating to the accrual of property taxes, that taxes accrue when the [73] statutory lien in support thereof attaches.

For example, the opinion purportedly distinguishes the cases of Magruder v. Supples, 316 U.S. 394, 29 AFTR 196, California Sanitary Company, Ltd., 32 B.T.A. 122, and Crown-Zellerbach Corp., 43 B.T.A. 541, upon the bare ground that "These cases involve generally the question of who was liable for local property taxes as between transferor and transferee."

It is true that the first two of the cited cases involved the question of who was entitled to a deduction, for federal tax purposes, of property taxes paid by a person who purchased the property and

paid taxes which were a lien before the date of purchase. It is not apparent, however, why this prevents the principle established therein from being applicable to cases involving the deduction of taxes where no transfer of property is involved. In the cases involving the right of a purchaser to deduct the property taxes paid by him, the Courts are merely determining when the liability for the tax accrued. If it accrued prior to the transfer, then, manifestly, it was not the tax of the transferee, and so could not be deducted by him. Conversely, however, it would necessarily follow that in such case the tax would be deductible by the transferor. As pointed out at page 47 of petitioner's opening brief, it is clear that if the tax thus accrues on [74] the lien date for purposes of determining who is entitled to a deduction therefor as between the seller or the purchaser, it must also accrue on the lien date for purposes of determining when it is deductible by a taxpayer on the accrual basis, even if no transfer of the property is involved. In fact, this is in effect the position asserted by the Chief Counsel of the Bureau of Internal Revenue in G.C.M. 21373 (1939-2 C. B., page 82). Furthermore, the Crown-Zellerbach case, also distinguished, as hereinabove noted, by the Court herein, involved simply the question of the proper year for the deduction of property taxes paid by the petitioner therein. No transfer was involved. Clearly, the purported ground of distinguishing these cases is without merit.

The opinion attempts further to distinguish the property tax cases—holding that property taxes accrue when the lien therefor attaches—upon the ground that (Opinion, page 8) "The nature and character of the franchise tax herein is essentially different from the property taxes involved in the above discussed cases." Of course, this is true in many respects. But the property tax cases were cited for, and support, the proposition that local taxes accrue, for Federal income tax purposes, on the date when there is personal liability therefor, or when the lien therefor attaches, whichever is earlier; and if such date [75] is specified in the local tax law, then it is immaterial that the tax is for a period commencing at a later date, or that at the designated accrual or lien date the taxes have not been assessed, or that the basis for computing the amount of the tax is still unknown (see Petitioner's Opening Brief, page 46), or even that the tax may in fact subsequently be abated or refunded. (Id., pp. 55-56.) The question is not whether the taxes are similar but whether the statutory provisions as to accrual of liability or as to the attaching of a lien in support of the taxes are similar. If the lien and/or accrual provisions are similar, then the fact that in the absence of such an accrual or lien provision the Court might well conclude that the character of the franchise tax is such that it does not accrue until some later time, is entirely immaterial. Manifestly, the opinion misconceives the problem here presented.

Further, in discussing the nature of the franchise tax involved herein, the Court states that under the terms of the Act withdrawal or dissolution may relieve the taxpayer from taxation for the portion of the "taxable year" during which the franchise privilege is not exercised. (Opinion, pp. 8-9.) As a matter of fact, no dissolution or withdrawal during the "taxable year" would completely relieve the taxpayer of liability for the franchise tax based on the income of the income year. At most, it would reduce the tax to the minimum amount prescribed by the act. [76] (See Petitioner's Opening Brief, pp. 32-35.) And, in any event, as is more fully discussed in Petitioner's Opening Brief herein (pp. 55 ff.), "accrual" is not synonymous with or dependent upon absolute certainty of payment of the full amount of the accrued liability. As the Trial Judge herein has, in another recent decision involving the proper time for the deduction of taxes accrued, very clearly pointed out, "The propriety of the accruals must be judged by the facts which petitioner knew or could reasonably be expected to know at the closing of its books for the taxable year * * *." (Baltimore Transfer Co., 8 T. C. 1 (No. 1), upholding the deduction in the amount accrued, notwithstanding a subsequent reduction in the amount of the tax.) The applicability of the principle thus stated in the cited case to the facts herein is self-evident. Here, in the light of the facts as of the close of the "income year" there was no reasonable possibility of the petitioner not being required to pay in full the

liability which it accrued; and subsequent events have only borne out petitioner's then appraisal of the facts, for the tax in question was in fact paid in full and has never been refunded or abated in any part. (See Petitioner's Opening Brief, pp. 32-35; Petitioner's Reply Brief, pp. 44-45.) Yet the Opinion herein does not even mention the Baltimore Transfer case. This case is more fully discussed in Petitioner's Reply Brief, pages 32-34, and 40-41. Also, in regard to the propriety of accruing taxes which [77] might be affected by certain contingencies, see the decision of the Trial Judge herein in Louisiana Delta Hardwood Lumber Co., Inc., 7 T. C. 994 (No. 116), and the discussion thereof and of other capital stock tax cases in Petitioner's Reply Brief, pages 41-45. It is not apparent how the decision herein by the Trial Judge can be reconciled with his decision in the above cited cases.

(c) Applicability of "expense"-deduction principles.

The Court herein also confuses the problem here presented—which is one of a deduction under I.R.C. Section 23(c) for taxes—with the problems involved in connection with deductions under I.R.C. Section 23(a) for expenses (see Opinion, page 9). The deduction for taxes is for taxes which accrue during the taxable year in question; and where there is a lien, the taxes accrue in the year in which they become a lien, regardless of whether the tax is for that year in the sense that a business

expense has to be for the taxable year. It is squarely so held in the Crown-Zellerbach case, supra. That case involved, amongst other taxes, property taxes imposed by the State of California. These taxes became a lien on the first Monday in March but were levied for and paid in the State fiscal period commencing the following July first and ending on June 30 of the next calendar year. The taxpayer in that case kept its books of account on the basis of a fiscal [78] year ending April 30, and used an accrual method of accounting. The question presented to the Board was the proper year in which to deduct these taxes. The taxpayer contended that it should be permitted to deduct in its fiscal year ended April 30, 1937, ten-twelfths of the California taxes which became a lien on the first Monday in March, 1936, and were for the State fiscal year July 1, 1936, to June 30, 1937 (because ten-twelfths of that State fiscal perod fell within said fiscal year of the taxpayer). In other words, the taxpayer's theory was, as is apparently the theory of the decision herein, that taxes must be deducted in the taxpayer's accounting period in which falls the period for which the taxes are imposed. The Commissioner, however, there contended that taxes were required to be deducted in the year in which they accrued, and that they accrued in the taxpayer's fiscal year in which fell the lien date prescribed by the local law. Thus, in the cited case, his contention was that the taxpayer was required to deduct in its fiscal year ended April 30, 1937, the California taxes which became

a lien on the first Monday in March, 1937, notwithstanding they were for the period July 1, 1937, to June 30, 1938. The Board upheld the Commissioner. Clearly, this is directly opposed to the decision in the case at bar.

Any language in tax deduction cases which might appear to apply the principles applicable to "expense" deductions will be found to relate to taxes for which no statutory accrual or lien date is prescribed. There is no authority, however, for the proposition that taxes which, under unequivocal provisions of the local tax law, accrue and become a lien in one taxable year of the taxpayer, may be shifted by the Commissioner to another taxable year merely because that is the year for which the tax is imposed. Certainly, no case cited in the Opinion so holds; and the Trial Judge apparently recognized this for, as noted, his whole discussion is based upon the false premise that the accrual and lien provisions of the California Franchise Tax Act have "no significance" except for purposes of establishing the State's priority.

It is interesting to note that it is only in connection with the discussion of the deduction for the franchise tax as a business expense, that any reference is made in the Opinion to a proper accrual date as being affected by the requirement that the accrual "properly reflect" petitioner's net income. It is merely declared (Opinion, page 9), without consideration of any authorities, that the tax was "* * * an expense which must necessarily be taken into account in the tax year 1944 in order

properly to reflect petitioner's net income in that year." Again, it is clear that the Court is completely disregarding the [80] provisions of the local tax statute specifying the date of accrual of, and of the lien for, the tax. Petitioner fully discussed in its opening brief (pages 65 and following) the matter of the application of Section 41 and 43 of the Internal Revenue Code relating to the necessity for reporting income and deductions in a manner which clearly reflects income. The case of Security Flour Mills v. Commissioner (1944), 341 U. S. 281, 31 AFTR 1214, 1216, should lay at rest any possible contention that these sections were intended to authorize the Commissioner to take deductions out of the year in which they in fact legally accrued and put them in some other year, upon the ground that this is necessary in order "to clearly reflect income." However, the Opinion herein does not even refer to the Security Flour Mills case. On this point, too, the decision in the Crown-Zellerbach case, supra, is of interest. In holding that the taxes there involved accrued when they became a lien, and in rejecting the contention of the taxpayer that these taxes should be accrued only in the proportion that they were for a tax period included in the taxpayer's fiscal year, the Board necessarily held that the method of accounting approved by it clearly reflected income. In the present case, under the unequivocal provisions of the State law, the tax accrued and became a lien on December 31, 1943, and under the principle established in the Security Flour Mills case, [81]

the Commissioner is not, under such facts, entitled to shift the accrual date to some undesignated time in 1944, under the guise of properly reflecting petitioner's net income.

In conclusion, it is respectfully urged that the report promulgated herein on July 30, 1947, is based upon clear errors of law which, if uncorrected by this Court, will leave the decision unsupportable. Furthermore, the matter is of such general interest to corporations doing business in California, that this Court should not permit said report to become the decision of the Court without a review by the entire Court. Attention is called to the fact that the petitioner's briefs herein are printed briefs, so that a review by the entire Court may be expeditiously had. It is respectfully submitted that the Presiding Judge should exercise his discretion to direct the report to be reviewed by the Court.

Dated at Los Angeles, California, August 15, 1947.

THOMAS R. DEMPSEY,
ELMO H. CONLEY,
JOSEPH D. BRADY,
JOHN O. PAULSTON,
By /s/ JOHN O. PAULSTON
Counsel for the Petitioner.

Received and filed Aug. 19, 1947.
Served Aug. 20, 1947.

Denied Aug. 21, 1947. Bolon B. Turner, Presiding Judge. [82]

[Title of Tax Court and Cause.]

PETITION FOR REVIEW

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now comes Central Investment Corporation, a corporation, by Joseph D. Brady and John O. Paulston, its attorneys, and respectfully shows:

I.

Jurisdiction and Venue

The petitioner on review (hereinafter sometimes referred to as the petitioner) is a California corporation. The respondent on review is the duly appointed, qualified, and acting Commissioner of Internal Revenue. The case involves the federal excess profits tax liability of petitioner [83] for the calendar year 1943. Respondent determined that there was a deficiency in petitioner's excess profits tax liability for said year in the amount of $34,971.23. The Tax Court of the United States, on July 30, 1947, promulgated its Findings of Fact and Opinion (per Judge Hill) upholding this determination by respondent, and on July 31, 1947, pursuant to said findings and opinion, entered its decision that there was a deficiency in excess profits tax due from petitioner for the year 1943 in the sum of $34,971.23. Thereafter, and prior to August 21, 1947, petitioner filed with the Tax Court a motion for a review by the full Court, but this

motion was denied by the Presiding Judge of the Tax Court on August 21, 1947. This petition for review is for a review of said decision by the Tax Court upholding respondent's determination of a deficiency, and is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code. The Court in which said review is sought is the United States Circuit Court of Appeals for the Ninth Circuit. Venue in said Ninth Circuit is established by the fact that petitioner's excess profits tax return for the taxable year 1943 was filed with the Collector of Internal Revenue for the Sixth District of California, located at Los Angeles, which collection district is within the jurisdiction of the Circuit Court of Appeals for the Ninth Circuit, and by the fact that the parties hereto have not stipulated that said decision by the Tax Court may be reviewed by any Court [84] of Appeals other than the one herein designated.

II.

Nature of Controversy

Petitioner is, and at all material times has been, the owner of the Biltmore Hotel in Los Angeles, California. It has kept its books and filed its tax returns on the accrual method and for the accounting period of the calendar year. On December 31, 1943, it accrued its liability for the California franchise tax, under the California Bank and Corporaton Franchise Tax Act, in the amount of $43,174.36, based upon its net income for the year 1943, and

in its federal income and excess profits tax returns for 1943 it claimed the deduction for said accrued liability. The amount so accrued was in fact paid by petitioner in 1944 at the times required by the California Bank and Corporaton Franchise Tax Act. It is not disputed that the amount so accrued was the correct amount of petitioner's franchise tax liability based upon its 1943 net income. The respondent determined, however, that this liability had not accrued in 1943, but would accrue only in 1944, and was therefore not deductible in determining the net income of 1943 for federal income or excess profits tax purposes. This determination by respondent was made notwithstanding that the California Bank and Corporation Franchise Tax Act expressly provides, and did provide on and prior to December 31, 1943, that taxes imposed by said Act accrued on the last day of [85] the year the income of which was the basis for the tax, and that said taxes should constitute a lien upon the real property of the taxpayer, which lien should attach on said last day of the year the income of which was the basis for said tax. The Tax Court upheld this determination of the respondent, upon the ground that these provisions of the Act had significance only in terms of priority of liens and did not affect the question of accrual for federal tax purposes.

The Tax Court of the United States erred:

1. In holding and deciding that the amount of $43,174.36, which was the amount of the

California franchise tax based upon petitioner's net income for the calendar year 1943, did not accrue on December 31, 1943.

2. In holding and deciding that said amount of $43,174.36 was not deductible by petitioner in computing its net income for federal income and excess profits tax purposes for the calendar year 1943.

3. In holding and deciding that said amount of $43,174.36 was deductible by petitioner in computing its net income for federal income and excess profits tax purposes for the calendar year 1944 only.

4. In holding and deciding that there was any deficiency in any sum whatsoever in the payment of petitioner's excess profits tax for the year 1943. [86]

5. In rendering an opinion and decision which, in the respects above enumerated, are contrary to the controlling law and the regulations, and are not supported by any evidence in the case.

Wherefore, petitioner prays that the decision of The Tax Court of the United States be reviewed by the Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said Court and be transmitted to the Clerk of said Court for filing; and that appropriate action be taken to

the end that the errors herein complained of may be reviewed and corrected by said Court.

Dated October 23, 1947.

/s/ JOSEPH D. BRADY,
/s/ JOHN O. PAULSTON,
Counsel for Petitioner
on Review.

Filed Oct. 30, 1947. [87]

[Title of Tax Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To the Honorable George J. Schoeneman, Commissioner of Internal Revenue, Internal Revenue Building, Washington, D. C., and the Honorable Charles Oliphant, Chief Counsel for the Bureau of Internal Revenue, Internal Revenue Building, Washington, D. C.:

You Are Hereby Notified that on the 30th day of October, 1947, the above petitioner filed with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of [88] Appeals for the Ninth Circuit of the decision of The Tax Court of the United States heretofore rendered in the

above-entitled cause. A copy of the petition for review as filed is attached hereto, and served upon you.

Dated this 30th day of October, 1947.

/s/ JOSEPH D. BRADY,
/s/ JOHN O. PAULSTON,
Counsel for Petitioner
on Review.

Service of the foregoing notice, together with a copy of the petition for review, is acknowledged this 30th day of October, 1947.

GEORGE J. SCHOENEMAN,
Commissioner of
Internal Revenue,
Respondent,

CHARLES OLIPHANT,
Chief Counsel for the Bureau
of Internal Revenue,

By /s/ CHARLES OLIPHANT, CAR

Filed Oct. 30, 1947. [89]

In the United States Circuit Court of Appeals
for the Ninth Circuit

Tax Court Docket No. 7959

CENTRAL INVESTMENT CORPORATION
(a corporation),

Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

ORDER DIRECTING TRANSMISSION OF ORIGINAL REPORTER'S TRANSCRIPT AND ORIGINAL EXHIBITS ON FILE WITH THE TAX COURT

The above-designated petitioner on review having duly filed its petition for a review of the decision of the Tax Court on the United States in a proceeding before said Tax Court bearing docket number 7959, in which proceeding the Tax Court rendered its decision on July 31, 1947, that there is a deficiency in federal excess profits tax owing by the petitioner for the calendar year 1943 in the amount of $34,971.23, and said petitioner having duly filed its Designation of the Contents of the Record on Review and having presented to this Court its Motion for Transmission of Original Reporter's Transcript and Original Exhibits on File with the Tax Court in lieu of transcribing said Reporter's Transcript and copying said exhibits into [90] the record on review:

It Is Hereby Ordered that the Clerk of the Tax

Court of the United States be, and he is hereby, directed to furnish the United States Circuit Court of Appeals for the Ninth Circuit with the original exhibits on file with the Clerk of the Tax Court in said action bearing docket number 7959 in the files of said Court, said original records to be in lieu of copying the same into the transcript prepared by the Clerk of the Tax Court of the record on review herein.

Dated, October 28, 1947.

WILLIAM DENMAN,
Acting Senior United States
Circuit Judge.

[Endorsed]: Filed Oct. 28, 1947. [91]

In The Tax Court of the United States
Docket No. 7959

CENTRAL INVESTMENT CORPORATION
(a corporation),

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S DESIGNATION OF CONTENTS OF RECORD ON REVIEW

To the Clerk of the Tax Court of the United States:

The above-designated petitioner, being also the

petitioner on review, hereby designates for inclusion in the record for consideration by the United States Circuit Court of Appeals for the Ninth Circuit on review of the decision of the Tax Court of the United States entered in said action on July 31, 1947, the following:

1. The docket entries of all proceedings before the Tax Court.

2. Pleadings before the Tax Court, including:

(a) Petition, including annexed Exhibit A (being a copy of deficiency letter and statement attached thereto).

(b) Answer. [92]

3. The complete record of all the proceedings and evidence taken before the Tax Court of the United States, together with copies of exhibits introduced in evidence, except that if the United States Circuit Court of Appeals for the Ninth Circuit orders and directs the transmission of the original Reporter's Transcript of the proceedings and evidence before the Tax Court to said Circuit Court of Appeals, the transmission of said original Reporter's Transcript may be deemed to be made in lieu of transcribing a copy thereof into the record prepared pursuant to this designation, and except that if the Circuit Court of Appeals for the Ninth

Circuit orders and directs the transmission of the original exhibits on file with the Clerk of the Tax Court to said Circuit Court of Appeals in their original form for the inspection of that Court, the transmission of such original exhibits may be deemed to be made in lieu of copying the same into the record prepared pursuant to this designation.

4. The Findings of Fact and Opinion of the Tax Court, promulgated July 30, 1947.

5. The Decision of the Tax Court, entered July 31, 1947.

6. Motion for Review by the Court of Report of a Division (Judge Hill).

7. Order dated August 21, 1947, denying motion for review by full Court. [93]

8. Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit.

9. Notice of Filing Petition for Review, together with proof of service thereof and of service of a copy of the Petition for Review.

10. This Designation of Contents of Record on Review.

Request is hereby made that a transcript of said record be prepared, certified, and transmitted by the Clerk of the Tax Court of the United States to the Clerk of the United States Circuit Court of

Appeals for the Ninth Circuit as required by law and the rules of said Circuit Court of Appeals.

Dated October 23, 1947.

/s/ JOSEPH D. BRADY,
/s/ JOHN O. PAULSTON,
Counsel for Petitioner.

Personal service of a copy of the foregoing Designation is hereby acknowledged as having been made this 30th day of October, 1947.

GEORGE J. SCHOENEMAN,
Commissioner of
Internal Revenue,
Respondent,

CHARLES OLIPHANT,
Chief Counsel for the Bureau
of Internal Revenue,

By /s/ CHARLES OLIPHANT, CAR.

Filed Oct. 30, 1947. [94]

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States, do hereby certify that the foregoing pages, 1 to 94, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 12th day of November, 1947.

[Seal] /s/ VICTOR S. MERSCH, EMT
Clerk, The Tax Court of
the United States.

[Endorsed]: No. 11796. United States Circuit Court of Appeals for the Ninth Circuit. Central Investment Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed November 21, 1947.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

No. 11796

CENTRAL INVESTMENT CORPORATION
(a corporation),

Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

DESIGNATION OF POINTS UPON WHICH PETITIONER INTENDS TO RELY AND OF PORTIONS OF RECORD NECESSARY FOR CONSIDERATION THEREOF

The certified typewritten transcript of record in the above-entitled cause having been duly filed with the Clerk of the above-entitled Court, and there also having been filed with said Clerk, pursuant to order of this Court duly made, the exhibits in their original form as filed in the proceeding in the Tax Court from which this review has been taken, the petitioner on review hereby designates the points upon which it intends to rely upon this review, and the portions of the record which are necessary for the consideration of said points and which shall be included in the printed record.

(a) The points upon which petitioner on review intends to rely upon this review are as follows:

1. The Tax Court of the United States erred in holding and deciding that the amount of $43,174.36, which was the amount of the California franchise tax based upon petitioner's net income for the calendar year 1943, did not accrue on December 31, 1943.

2. The Tax Court of the United States erred in holding and deciding that said amount of $43,174.36 was not deductible by petitioner in computing its net income for federal income and excess profits tax purposes for the calendar year 1943.

3. The Tax Court of the United States erred in holding and deciding that said amount of $43,174.36 was deductible by petitioner in computing its net income for federal income and excess profits tax purposes for the calendar year 1944 only.

4. The Tax Court of the United States erred in holding and deciding that there was any deficiency in any sum whatsoever in the payment of petitioner's excess profits tax for the year 1943.

5. The Tax Court of the United States erred in rendering an opinion and decision which, in the respects above enumerated, are contrary to the controlling law and the regulations, and are not supported by any evidence in the case.

(b) The portions of the record necessary for the consideration of said points and required to be included in the printed record, are as follows:

> The entire typewritten transcript of record filed in said cause, together with the original exhibits heretofore transmitted to this Court in their original form, except only Exhibits A and B; provided, however, that if this Court orders and directs that said exhibits, other than Exhibits A and B, shall be omitted from the printed record but that said omitted exhibits shall be considered by the Court in their original form as though set out in the printed record, then, and only then, said entire typewritten transcript of record, only (not including any of the exhibits), is necessary for the consideration of this review and shall be included in the printed record.

Dated, November 26, 1947.

/s/ JOSEPH D. BRADY,
/s/ JOHN O. PAULSTON,
Counsel for Petitioner
on Review.

[Endorsed]: Filed Nov. 28, 1947.

[Title of Circuit Court of Appeals and Cause.]

ORDER FOR CONSIDERATION OF ORIGINAL EXHIBITS

The above-designated petitioner on review having duly filed its motion for consideration, in their original form, of the exhibits heretofore transmitted to this Court by the Clerk of the Tax Court, and good cause therefor appearing:

It Is Hereby Ordered that Exhibits A, B, C, D, E, F, and G, introduced in evidence before the Tax Court of the United States in the proceeding from which the present review has been taken, and heretofore transmitted to this Court in their original form and now in the files of the above-entitled proceeding on review in this Court, shall be omitted from the printed record on review herein, and that said omitted exhibits shall be considered by this Court in connection with this review in their original form as though set out in said printed record on review.

Dated, November 28, 1947.

/s/ FRANCIS A. GARRECHT,
Senior United States
Circuit Judge.

[Endorsed]: Filed Nov. 28, 1947.